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IN THE

# Supreme Court of the United States

OCTOBER TERM, 1946
No. 92

WALTER P. GARDNER, Trustee of THE CENTRAL RAILROAD COMPANY OF NEW JERSEY,

*Petitioner,*

*vs.*

STATE OF NEW JERSEY,

*Respondent.*

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT.

## PETITION OF STATE OF NEW JERSEY FOR REHEARING.

WALTER D. VAN RIPER,
*Attorney-General of New Jersey,*
*Attorney for Respondent,*
*State House, Trenton, N. J.*

BENJAMIN C. VAN TINE,
*Of Counsel.*

February 10, 1947.

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## PETITION OF STATE OF NEW JERSEY FOR REHEARING.

*To the Honorable Justices of the Supreme Court of the United States:*

The petition of the State of New Jersey, respondent in the above-entitled cause, respectfully prays for a rehearing in the said cause for the reasons hereinafter shown. Judgment was rendered in the said cause on January 20, 1947.

I.

Your petitioner respectfully shows that there was no "lien of a State" for taxes within the issues of *VanHuffel* vs. *Harkelrode*, 284 U. S. 225.

This Court apparently laid considerable stress on *VanHuffel* vs. *Harkelrode*, *supra*, to support the proposition that the bankruptcy court has certain broad powers with respect to the pre-existing "lien of a State" for taxes. Reference to the record in that case discloses that it was not taxes due a State but taxes due to Trumbull County, Ohio, that were in issue. The words "states taxes" were used in the sense that it has often been said that all taxes are state taxes for the reason that they can be levied only by authority of State law. Your petitioner begs leave to present to this Court the true facts of this case.

Since *VanHuffel* vs. *Harkelrode*, *supra*, dealt only with taxes due a county, it could be of no help whatsoever in the determination of the question of a State's immunity from process with respect to pre-existing tax liens. Concerning the question of immunity, your petitioner respectfully calls to the attention of this Court, that this Court has long since held that there is a distinction between a State and the subdivisions thereof with respect to such immunity.

In *Hopkins* vs. *Clemson College*, 221 U. S. 636, 645, this Court said:

> "In *County of Lincoln* vs. *Luning*, 133 U. S. 529, 530, the court said that: 'While a county is territorially a part of the State, yet politically it is also a corporation, created by and with such powers as are given to it by the State. In this respect it is a part of the State only in that remote sense in which any city, town, or other municipal corporation may be said to be a part.' The court there held that the Eleventh Amendment

was limited to those cases in which the State is the real party, or party on the record, but that counties were corporations which might be sued."

The only question involved in the *VanHuffel* case was the very limited question concerning the power of the Bankruptcy Court to transfer the lien for taxes to the proceeds of the sale where the court otherwise had jurisdiction of the parties. The *VanHuffel* case is reported in *American Law Reports*, 78 A. L. R. 453. The annotation on page 458 is illuminating:

"This annotation is supplemental to that in 35 A. L. R. 255.

"The rule stated in the earlier annotation, that a court of equity may under proper circumstances order a sale by the receiver of the property being administered upon, free from liens, and remit the lienor to the proceeds, is supported by the more recent decision in *Davis* vs. *Patterson* (1930) 180 Ark. 918, 25 S. W. (2d) 452, in which it was said: 'The parties all being before the court, it had the right to order a sale of the property free of all claims, liens, and encumbrances for disposition of the proceeds among the parties entitled thereto upon proper adjudication of their rights.'"

That Mr. Justice Brandeis, who wrote the opinion in the *VanHuffel* case, also believed this to be the rule of that case is shown by *Louisville Bank* vs. *Radford*, 295 U. S. 555, wherein the eminent Justice said for this Court, at page 583:

"Bankruptcy acts had, either expressly, or by implication, as was held in *VanHuffel* vs. *Harkelrode*, 284 U. S. 225, 227, authorized the court to direct, in the interest of other creditors, that all liens upon prop-

erty forming a part of the bankrupt's estate be marshalled; that the property be sold free of encumbrances; and that the rights of all lienholders be transferred to the proceeds of the sale—a power which 'had long been exercised by federal courts sitting in equity when ordering sales by receivers or on foreclosure.' *First National Bank* vs. *Shedd*, 121 U. S. 74, 87; *Mellon* vs. *Moline Malleable Iron Works*, 131 U. S. 352, 367. Compare *Ray* vs. *Norseworthy*, 23 Wall. 128, 135. But there had been no suggestion that such a sale could be made to the prejudice of the lienor, in the interest of either the debtor or of other creditors. By the settled practice, a sale free of liens will not be ordered by the bankruptcy court if it appears that the amount of the encumbrance exceeds the value of the property."

And at page 589:

"The bankruptcy power, like the other great substantive powers of Congress, is subject to the Fifth Amendment."

*Ray* vs. *Norseworthy*, *supra*, and the *Louisville Bank* case were cited by the State in its original brief.

II.

Your petitioner respectfully shows that *New York* vs. *Irving Trust Company*, 288 U. S. 329, was not concerned with pre-existing liens of a State for taxes.

The sole question involved in the *Irving Trust Company* case was the power of the Court to issue a bar order compelling a State to make proof of claim under Section 64 of the bankruptcy act or be forever barred from any share

in the assets available for unsecured creditors. This Court said, at page 331:

> "It is admitted here, that as the United States and the States are not mentioned in the limitation of § 57, they are not bound thereby The consequent necessity for bar orders is apparent. Otherwise, estates could not be promptly closed." (Citing cases.)

Your petitioner is unable to find of record any case wherein bar orders were used for any purpose except to wipe out claims against assets available for distribution to general unsecured creditors. Your petitioner sought to show in detail in its original brief that Section 64 is in no wise applicable to pre-existing liens. The State's argument stands unchallenged.

In this connection your petitioner begs leave to re-argue the point whether, if there was any inherent power in the Bankruptcy Court to hear questions concerning the legality of taxes, why Congress should have deemed it necessary to grant specific power to the Bankruptcy Court to determine the amount and validity of wholly unsecured taxes claiming the grace of priority under Section 64.

In connection with this case, your petitioner respectfully inquires why if the State is a creditor in the broad sense held by this Court in its opinion, the said State should be permitted to participate in creditors' meetings only in the qualified manner prescribed by Section 57e.

## III.

**Your petitioner respectfully shows that *VanHuffel* vs. *Harkelrode, supra,* and *New York* vs. *Irving Turst Co., supra,* are not authority for the rule stated by this Court to the effect that in bankruptcy cases "the authority of the Court to deal with the lien of a State has long been recognized."**

The above mentioned cases cited by this Court in support of the stated rule do not stand up under scrutiny. Nor is the matter helped in any wise by the rule of *New York* vs. *Maclay*, 288 U. S. 290, and *U. S.* vs. *Texas*, 314 U. S. 480, cited by this Court just before the other two cases. In each of these latter cases the issue was between the United States Government and a State, each claiming certain priorities. But in neither of these cases was the Court concerned with a pre-existing lien of a State for taxes.

The State has never argued that the immunity granted by the 11th Amendment or by the inherent nature of sovereignty has been such as to prevent the United States Government asserting a claim against a State. As to the specific issues of those cases, the taxes due to the State were not liquidated and apparently on this narrow distinction the taxes of the United States were given priority under a specific statute. But as shown at pages 292-293 of the *Maclay* case, the rule stated therein with respect to the claims of the United States does not apply with respect to the claims of a State against private interests.

Your petitioner respectfully submits that the State can show that, even with respect to the claims of the United States, Congress had generally recognized a pre-existing tax lien of a State as being paramount to the lien of the United States for taxes of subsequent years. With respect to the instant matter, your petitioner respectfully submits that a reargument will clearly disclose that none of the cases cited by this Court support the rule stated in its opinion.

## IV.

**Your petitioner respectfully shows that prior to the passage of Section 77 neither a State nor any other lien claimant was required to file a claim for pre-existing liens or be barred of vested rights in the property of a bankrupt.**

Your petitioner respectfully submits that throughout the opinion of this Court there runs the thought that at the time of the passage of Section 77 the rule was clearly established that a State having pre-existing liens for taxes could be compelled to participate in bankruptcy proceedings or be barred from any interest in the liened property.

Your petitioner set forth at length in its original brief the cases supporting the rule that the Bankruptcy Court takes property in the same "plight and condition" in which the bankrupt had it at the time of bankruptcy. This argument has never been answered. Your petitioner has set forth the rule that the bankruptcy power is subject to the due process clause, *Louisville Bank* vs. *Radford, supra.* Your petitioner respectfully asserts that prior to the passage of Section 77, there was no rule or statutory provision whatsoever requiring either a private or governmental pre-existing lien claimant to file a claim against a bankrupt's estate. Inchoate liens were established in the manner prescribed by law and claims were only filed by those who sought distribution under Section 64, having to do only with assets available for distribution to unsecured claimants. The Trustees have, in fact, shown cases where the unqualifiedly filing of claims by lienors, in fact, forfeited such liens.

Your petitioner respectfully urges that reargument should be permitted which will clearly establish the fact that prior to March 3, 1933, the date of the passage of Section 77, *Missouri* vs. *Fiske*, 290 U. S. 18, *Ex Parte New York*, 256 U. S. 490, and *Palmer* vs. *Ohio*, 248 U. S. 32,

would have controlled the disposition of this case by reason of the necessity of the service of process in order to make the State a party. The later cases of *Great Northern Insurance Company* vs. *Read*, 322 U. S. 47, and *Ford Motor Co.* vs. *Indiana*, 322 U. S. 459, lend weight to that well-entrenched pre-existing rule.

## V.

**Your petitioner respectfully shows that Congress, in the light of its historic policy, could never have intended that a State should be a "creditor" under Section 77 of the Bankruptcy Act.**

This Court has said in its opinion:

> "We find not the slightest suggestion that Congress left out the large class of tax claims which recurringly appears in reorganizations and often assumes, as here, large proportions."

Your petitioner respectfully submits that this is not the test. The test is not whether Congress intended to exclude but whether Congress specifically intended to include. Your petitioner is of the earnest belief that upon a reargument it will be able conclusively to show that Congress never intended that a State should be a "creditor" under the said Section 77. The mere multiplicity of tax claims which must arise in railroad reorganizations, as pointed out by this Court, and the failure in this very lengthy act to mention the word "taxes" even once should of itself be dispositive of the question. Your petitioner is deeply puzzled why, for the first time in 14 years, notwithstanding such multiplicity of tax claims, it should now become so apparent that the rule is as stated by this Court and Sec-

tion 77 so clearly applies. During the past 14 years it has always been found necessary to try to read into Section 77 either Section 64 or 57 or 67 if taxes were involved.

Your petitioner freely admits that if prior to March 3, 1933, the rule had been that a State could be required to come into any ordinary bankruptcy proceedings regardless of its consent and notwithstanding it had pre-existing tax liens, we must find in Section 77 words that would change such rule. But the Trustees have shown no authority whatsoever in the law to support any such rule. Your petitioner submits, therefore, that there must be found within Section 77 the authority for the rule now stated by this Court.

What was the intent of Congress? For such intent we must not look to the circumstances of the present cause but to the circumstances and conditions at the time of the passage of Section 77 on March 3, 1933 (47 Stat., ch. 204). The word "taxes" was not used once in that lengthy statute. The said statute provided:

> "If the United States of America is directly a creditor or stockholder, the Secretary of the Treasury is hereby authorized to accept or reject a plan in respect of the interests or claims of the United States."

Your petitioner respectfully shows that in the preceding year the Reconstruction Finance Corporation was created with authority to make loans to railroad companies. The Government had gone into the lending business and was truly a creditor.

Your petitioner submits that the said Section 77 must be read in the light of the troublesome conditions of the time. No one can forget the years just prior to and just subsequent to the year 1933. Thousands upon thousands of "little men" lost everything they had, their businesses, their homes, their hopes. But they didn't lose their obligation to pay any taxes for which they had been personally

liable. By Section 17 (11 U. S. C. A. Section 35) taxes were not dischargeable in bankruptcy. Your petitioner respectfully inquires whether it can be said that Congress in 1933 was so mindful of the corporation as to provide that the taxing authorities should be such creditors as could be wiped out in a reorganization scheme while requiring that these "little men" should still bear the cross of their defaulted unpaid taxes? Congress gave its answer to this question in no uncertain terms when by Section 77(l) it put a railroad in reorganization in the same position as the "little man" who had filed his petition in bankruptcy. Clearly it was intended that taxes should not be dischargeable in either case.

If anything more were needed, it was supplied by Section 77(B), wherein it was specifically provided that Section 64, the only section wherein there is given the authority to review the amount and validity of taxes, was not applicable so long as the Section 77(B) proceedings were reorganization proceedings. The said Section 64 only applied in case of liquidation. Congress did not provide for liquidation under Section 77.

Your petitioner respectfully submits that Congress intended all state taxes to be paid by any corporation in reorganization. If a corporation was not able to discharge such public liabilities, it was not a fit subject of a reorganization.

On August 27, 1935 (49 Stat. 911, ch. 774) the said Section 77 was amended to change the above provision with respect to the Reconstruction Finance Corporation. But again no mention was made of taxes, notwithstanding that the act had now been operating for two years and there was the above mentioned multiplicity of tax claims.

On June 26, 1936 (49 Stat. 1967, ch. 833) the said Section 77 was for the first time amended so as to include taxes and customs' duties due to the United States. Your petitioner believes that the failure of Congress to mention taxes due to a State and its political subdivisions, when after three years of operation the question of taxes was particularly in mind, is of the deepest significance.

Your petitioner respectfully points out that in *Railroad Commission* vs. *Pullman Co.*, 312 U. S. 496, this Court at page 500 called attention to the "scrupulous regard for the rightful independence of the state governments" and spoke further of the "harmonious relation between state and federal authority." In *Chicago* vs. *Fieldcrest Dairies*, 316 U. S. 168, this Court said at page 173:

> "For we are here concerned with the much larger issue as to the appropriate relationship between federal and state authorities functioning as a harmonious whole."

To the same effect are *Spector Motor Service* vs. *McLaughlin*, 232 U. S. 101, and *Thompson* vs. *Magnolia Petroleum Co.*, 309 U. S. 478. Your petitioner believes that this Court was not intending to be expansively gracious when it made the above ruling but that this Court was asserting a definite and salutary principle of law. Your petitioner urges that Congress was no less mindful of that nice relationship that should exist between local taxing authorities and the Federal Government when it enacted legislation with respect to railroad and other corporate reorganizations. The whole history of bankruptcy proves that Congress has been ever mindful of the duty it owed the States and local taxing authorities, and that, just as this Court did in *Palmer* vs. *Massachusetts*, 308 U. S. 79, 83, Congress has recognized the need of a nice balance between national and State authority in this "sensitive area of government."

Your petitioner respectfully shows the following that should disclose the true attitude of Congress. 1.) Congress has always made taxes non-dischargeable. 2.) Congress has given taxes a priority in the distribution of general assets under Section 64, where otherwise such taxes would only share ratably with other general creditors. 3.) Con-

gress has provided by act of January 8, 1934 (28 U. S. C. A. Section 124a) that a Trustee in bankruptcy conducting a business "shall be subject to all State and local taxes applicable to such business, the same as if such business were conducted by an individual or corporation." 4.) Congress specifically limited the application of Section 64, in 77B proceedings to cases of liquidation.

Your petitioner submits that all of the above, together with the well established rule of law at the time of the passage of the said Section 77, to the effect that taxes were not debts and that a debtor-creditor relationship did not arise by reason of the obligation to pay taxes, must lead to the conclusion that Congress never intended that a State having a pre-existing tax lien should be a creditor in a railroad reorganization proceedings.

Your petitioner submits that Section 57(n) does not in any wise change what has been said above. The said section was passed in order to eliminate the necessity of bar orders. The said section is only applicable in cases where elsewhere in the Bankruptcy Act there is a requirement that a claim be filed.

Your petitioner respectfully submits that a reargument will show that every rule of logic, every principle of consistency and probability, must lead to the inescapable conclusion that Congress did not intend that a State having pre-existing liens for taxes should be a creditor under Section 77 of the Bankruptcy Act.

## VI.

**Your petitioner respectfully submits that this Court has not disposed of the constitutional questions raised by the petitioner in the light of the law as it actually existed at the time of the passage of the said Section 77.**

This Court said in its opinion "in the present circumstances there is no collision between § 77 and the Constitution." Your petitioner has admitted that, if this Court properly stated the law as it existed prior to 1933 the issue of constitutionality would have been disposed of. Your petitioner respectfully submits that it has shown that such was not the law, and that on the contrary that the law was clear that, with respect to any vested interest existing at the time of bankruptcy, it was necessary to issue process before jurisdiction could be obtained over any lienor, notwithstanding that the Bankruptcy Court or its agent had possession of the property in question.

Your petitioner has advanced the constitutional question with respect to the right of Congress to compel a State to be a party to any proceedings without its consent. Your petitioner respectfully requests the opportunity to reargue the question of the "collision between Section 77 and the Constitution" in the light of the law as it actually existed on the date of the passage of the said Section 77.

## VII.

**Your petitioner respectfully submits that the effect to be given the actions of the State fiscal officers must be viewed in the light of the true state of the law.**

All of the above has been directed either to the law as it existed prior to the passage of Section 77 or to the intent and power of Congress at the time of such passage. If, directing our attention to such times, it should be finally determined that a State having pre-existing liens for taxes

can be compelled to be a party to Section 77 reorganization proceedings or forfeit its rights in and to liened property, then clearly the State fiscal officers had power to file the proofs of claim in order to protect the State's interests. The State in such an event would not be an "actor" but would be a party to the proceedings by compulsion. Your petitioner respectfully submits that it is no answer to say that the State might stay out, if it saw fit, and forfeit the great sum of money due it.

Your petitioner respectfully submits that it only becomes necessary to determine whether the State is an "actor" if it should be determined that Congress did intend to include a State as a creditor in Section 77 proceedings and that, in order to make the act constitutional, it is necessary to read consent into the said section. Your petitioner therefore respectfully submits that, if it becomes necessary to consider the power of the State fiscal officers to file the said proofs of claim, the consideration of such power must be made in the light of the true state of the law.

Your petitioner respectfully calls to the attention of this Court that it has reversed the Bankruptcy Court with respect to its power to redetermine the amount and validity of the taxes due to the State. It is respectfully submitted that the Bankruptcy Court's claimed power under Section 64 might have had a controlling influence in leading the said Court to its conclusion that the State fiscal officers had the power to file the said proofs of claim. For such reason alone this case should be recalled for the purpose of sending it back to the Bankruptcy Court with the proper instructions.

Your petitioner is of the belief that, if it should be finally determined that a State may not be made a party without its consent and the issue becomes one of consent, an altogether different question will be presented to the Bankruptcy Court with respect to the existence of authority of State officials to bring the State into reorganization pro-

ceedings. It is respectfully submitted that a reargument should be had with respect to the power of the State fiscal officers to bind the State in the event that the State may not be made a party to a Section 77 proceedings without its consent or in the event that the action of the said officers played any substantial part in this Court's determination.

WHEREFORE, Your petitioner prays that this Honorable Court may grant to the State of New Jersey a rehearing in the above entitled cause and your petitioner further prays that this Honorable Court may grant leave to the said State to file a supplemental memorandum with respect to the *Van Huffel* vs. *Harkelrode* case and concerning the intent of Congress with respect to the inclusion of a State with pre-existing liens as a creditor in Section 77 proceedings.

STATE OF NEW JERSEY,

By WALTER D. VAN RIPER,
*Attorney-General,*

BENJAMIN C. VAN TINE,
*Deputy Attorney-General,*
*Attorneys for Respondent,*
*State House, Trenton, N. J.*

Dated: February 10, 1947.

CERTIFICATE OF COUNSEL.

I, BENJAMIN C. VAN TINE, Deputy Attorney-General, attorney for the State of New Jersey, do hereby certify that the foregoing petition is filed in good faith and not for delay.

BENJAMIN C. VAN TINE.

Dated: February 10, 1947.

# SUPREME COURT OF THE UNITED STATES

No. 92.—October Term, 1946.

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| Walter P. Gardner, Trustee of the Central Railroad Company of New Jersey, Petitioner, *v.* The State of New Jersey. | On Writ of Certiorari to the United States Circuit Court of Appeals for the Third Circuit. |

[January 20, 1947.]

Mr. Justice Douglas delivered the opinion of the Court.

This case, here on certiorari, presents important problems under § 77 of the Bankruptcy Act. 49 Stat. 911, 11 U. S. C. § 205. The Central Railroad Company of New Jersey (the debtor), of which petitioner is trustee, filed its petition for reorganization in 1939 shortly after receiving notice from the Attorney General of New Jersey that he would apply to a state court for a summary judgment for unpaid taxes of the debtor and seek to sell its property in satisfaction of the judgment. The tax assessments for the years 1932 to 1939 had been extensively litigated both in the state and federal courts and the results were for the most part adverse to the debtor.[1] By the end of 1939 the tax claims of the State against the debtor, exclusive of interest and penalties, exceeded $15,000,000, while the liquid assets of the debtor available to pay them were apparently less than half that amount. The reorganization court stayed suits to collect the taxes but from time to time entered orders directing the debtor to make specified installment payments on account of the taxes for various years.

In 1941 the New Jersey legislature passed a law designed to lessen the tax burden of railroads in the State. P. L. 1941, chs. 290, 291. This law was implemented and some-

[1] The history of the litigation is reviewed in the opinion of the Circuit Court of Appeals in this case. 152 F. 2d pp. 408–411.

what modified in 1942. P. L. 1942, chs. 169, 241. These acts included changes in the tax rates and provided for installment payments of the full principal amount of unpaid property taxes without interest or penalties, which were due on or before December 1, 1940. The statutory settlement of the claims was conditioned on (1) the execution of installment payment plans and the payment of the first installment, and (2) a waiver of all rights to contest the legality or amount of any assessment made prior to December 1, 1941, together with written consent to the discontinuance and dismissal of all pending suits concerning such assessments. The reorganization court authorized petitioner to settle and compromise the delinquent taxes in accordance with the provisions of these acts. Petitioner undertook to comply with the statutory requirements, filing documents and payments required of a delinquent taxpayer, discontinuing litigation, and consenting to the discontinuance of pending appeals.[2] The state officials—the Attorney General, Treasurer, and Comptroller—did not accept these tenders.[3] Instead, the Attorney General instituted suit to enjoin the Treasurer from carrying out the provisions of the 1941 and 1942 acts. The result was a holding that the acts violated the New Jersey constitution. *Wilentz* v. *Hendrickson*, 135 N. J. Eq. 244, 38 A. (2d) 199.

Meanwhile the reorganization court set a time within which all claims against the debtor should be filed. In compliance therewith the state Comptroller filed on behalf of the State of New Jersey a claim for taxes owing it.[4]

[2] Delinquencies of subsidiary companies of the debtor were also included.

The 1942 Act increased the 1941 franchise tax of the debtor. The waiver authorized by the reorganization court included a waiver of the right to contest the legality of that additional assessment.

[3] See *In re Central R. Co. of New Jersey*, 136 F. 2d 633, which contains a review of the facts of this episode.

[4] Like claims were also filed against subsidiaries of the debtor.

The proof of claim stated that over $18,000,000 had been paid on the tax claim, leaving unpaid some $12,000,000, plus interest of over $7,700,000, plus additional interest on those sums from December 1, 1940. The proof of claim also stated that under New Jersey law the sums owed were secured by "a lien paramount to all other liens upon all the lands and tangible property and franchises of the company in this State".

The debtor and trustee filed initial objections to the claim. They contended that the property of the debtor was grossly overvalued and that the debtor and other railroads had been intentionally and systematically discriminated against in the making of the assessments. They also objected to the interest or penalty part of the claim, contending, *inter alia*, that no interest accrued after the date when the debtor's petition for reorganization was filed or during the period when collection of the taxes was enjoined and the debtor was in good faith contesting their validity. Subsequently they objected to the claim on the further ground that its amount and the time allowed for its payment were governed by the terms of settlement or compromise tendered under the 1941 and 1942 acts of the New Jersey legislature. They also contended that New Jersey had no lien on the debtor's personal property. Like objections were made by a group of security holders of the debtor and by an indenture trustee. They also objected to the State's claim on the ground that no part of it other than that representing the principal amount of taxes was entitled to a lien equal or paramount to the debtor's general mortgage.

New Jersey, through her Attorney General, filed replies to the various objections which had been made to her claim, stating, *inter alia*, that the principal amount of the claim had been finally adjudicated and was lawfully owing, that the principal amount together with interest was entitled to priority under § 64 of the Bankruptcy Act, and

that the claim was entitled to a paramount lien on all the lands, tangible property, and franchises of the debtor.

Shortly after *Wilentz* v. *Hendrickson, supra,* was decided, the trustee filed with the reorganization court a petition for adjudication of New Jersey's tax claims which in substance recapitulated his earlier objections to the claim and asked for an adjudication that the settlement or compromise tendered under the 1941 and 1942 acts of New Jersey was binding; or alternatively, if it was not binding, a determination of the extent to which the claim should be allowed and the relative rights, liens and priorities of the various claimants in the debtor's assets.

The Attorney General of New Jersey thereupon entered a special appearance in the proceedings, claiming, *inter alia,* that the entertainment of the petition would constitute a prohibited suit against the State, both as respects the determination of the amount of the claim and its priority or lien.

The reorganization court referred New Jersey's claim to a special master to consider this additional contention of the State, as well as the previous objections to it and the State's replies thereto.

The special master rendered a report in 1945 in which he found (1) that the proofs of claim of New Jersey were properly filed by state officers acting in pursuance of their statutory authority; (2) that § 77 confers on the reorganization court jurisdiction over the kind of claims asserted by the State in the proceeding and that such construction of the Act is not unconstitutional; and (3) that the entire property of the debtor is *in custodia legis* subject to the rights of lienholders, and that the reorganization court is the proper court to determine the validity and amount of the tax claims and their lien, subject to the limitations of *Arkansas Corporation Commission* v. *Thompson,* 313 U. S. 132, which he did not think were presently involved in the proceedings. New Jersey, through

her Attorney General, filed objections to the report. The reorganization court overruled them and adopted and confirmed the report. New Jersey took an appeal to the Circuit Court of Appeals. She also filed in that court a petition for a writ of prohibition in which she challenged the rulings of the reorganization court on the same grounds.

The Circuit Court of Appeals treated the appeal as if all of the questions presented were covered by *Arkansas Corporation Commission* v. *Thompson, supra.* It held that the "only matters left open" for the reorganization court were (1) mathematical error in the computation of the amount of the tax or (2) legal error in its assessment. It accordingly reversed the order of the reorganization court and dismissed the application for a writ of prohibition. 152 F. 2d 408, 418.

*First.* We think, contrary to the position of New Jersey, that the reorganization court had jurisdiction over the proof and allowance of the tax claims and that the exercise of that power was not a suit against the State. Section 77 deals not only with claims of private parties but with those of public agencies as well. Section 77 (b) defines "creditors" as "all holders of claims of whatever character against the debtor or its property, whether or not such claims would otherwise constitute provable claims under this Act". And "claims" are defined to include "debts, whether liquidated or unliquidated, securities (other than stock and option warrants to subscribe to stock), liens, or other interests of whatever character." *Id.* And § 77 (c) (7) provides for the prompt fixing of a reasonable time within which the "claims of creditors" may be filed and the manner in which they may be filed and allowed. The words "all holders of claims" have no qualification and are sufficiently broad to include public agencies as well as private parties. The "claims" of creditors include secured and unsecured claims. We find not

the slightest suggestion that Congress left out the large class of tax claims which recurringly appears in reorganizations and often assumes, as here, large proportions. They are expressly included among provable claims in § 57n of the Bankruptcy Act, 52 Stat. 840, 867, 11 U. S. C. § 93 (n).[5] And the sweeping, all inclusive definitions of "claims" and "creditors" in § 77 leave room for no exception under it.

When a State files a proof of claim in the reorganization court, it is using a traditional method of collecting a debt. A proof of claim is, of course, *prima facie* evidence of its validity. *Whitney* v. *Dresser*, 200 U. S. 532. But the bankruptcy court whose aid is sought for enforcement of an asserted claim is not bound to treat the tendered proof as conclusive. When objections are made, it is duty bound to pass on them. That process is, indeed, of basic importance in the administration of a bankruptcy estate whether the objective be liquidation or reorganization. Without that sifting process, unmeritorious or excessive claims might dilute the participation of the legitimate claimants.

It is traditional bankruptcy law that he who invokes the aid of the bankruptcy court by offering a proof of claim and demanding its allowance must abide the consequences of that procedure. *Wiswall* v. *Campbell*, 93 U. S. 347, 351. If the claimant is a State, the procedure of proof and allowance is not transmuted into a suit against the State because the court entertains objections to the claim. The State is seeking something from the debtor. No judgment is sought against the State. The whole process of proof, allowance, and distribution is, shortly speaking, an adjudication of interests claimed in a *res*. It is none the less such because the claim is rejected *in toto*, reduced in part, given a priority inferior to that claimed, or satisfied in some way other than payment in cash. When

[5] See H. Rep. No. 1409, 75th Cong., 1st Sess., p. 13; S. Rep. No. 1916, 75th Cong., 3d Sess., pp. 5, 16.

the State becomes the actor and files a claim against the fund, it waives any immunity which it otherwise might have had respecting the adjudication of the claim. See *Clark* v. *Barnard*, 108 U. S. 436, 447–448; *Gunter* v. *Atlantic Coast Line*, 200 U. S. 273, 284–289; *Missouri* v. *Fiske*, 290 U. S. 18, 24–25.

The extent of the constitutional authority of the bankruptcy court in this respect was passed upon in *New York* v. *Irving Trust Co.*, 288 U. S. 329. In that case the Court sustained an order of the bankruptcy court which barred a State's tax claim because not filed within the time fixed for the filing of claims. The Court stated, p. 333, "If a state desires to participate in the assets of a bankrupt, she must submit to appropriate requirements by the controlling power; otherwise, orderly and expeditious proceedings would be impossible and a fundamental purpose of the Bankruptcy Act would be frustrated."

In the present circumstances there is, therefore, no collision between § 77 and the Constitution.

Nor can we conclude that the claim was not properly filed by the State. The state Comptroller, who filed the claim on behalf of the State, is authorized to "institute and direct prosecution . . . for just claims and debts due to the state". N. J. R. S. § 52: 19–10c. And see *id.*, § 52: 19–15. The state Attorney General, who resisted the objections made to the claim, is authorized to "attend generally to all matters in which the state is a party or in which its rights and interests are involved". *Id.*, § 52: 17–2g. The special master, whose report the reorganization court adopted, held that what these officials did in this case was in pursuance of their authority. For that conclusion he relied on the statutes which we have mentioned and the practice in other reorganization proceedings. That construction of New Jersey law made by a federal judge of the New Jersey District Court is entitled to special weight. *Steele* v. *General Mills*, decided January 6, 1947. We find nothing which impeaches it. To hold otherwise

might, indeed, imperil the claim which New Jersey so vigorously asserts. For it appears that the time for filing claims has expired and under the rule of *New York* v. *Irving Trust Co., supra*, a filing at this late date might come too late.[6]

*Second.* New Jersey contends that Congress did not include a State's tax liens within the scheme of § 77 proceedings. That is but another way of saying that since the State's asserted liens attached before the reorganization petition was filed, the only property of the debtor *in custodia legis* was its equity after the tax liens were satisfied.

We do not agree with that conclusion. We partially answered the contention when we reviewed the broad, all inclusive nature of the definitions of "creditors" and "claims" contained in § 77 (b). As those definitions make plain, "all holders of claims" include those who assert "liens" against the property of the debtor.

Section 77 (b), moreover, gives the reorganization court broad powers over all types of liens. Thus a plan of reorganization "shall include provisions modifying or altering the rights of creditors generally, or of any class of them, secured or unsecured, either through the issuance of new securities of any character or otherwise". § 77 (b) (1).

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[6] See *Meyer* v. *Fleming*, 327 U. S. 161, 169, footnote 18: "Sec. 77 (c) (7) provides that the judge 'shall promptly determine and fix a reasonable time within which the claims of creditors may be filed or evidenced and after which no claim not so filed or evidenced may participate except on order for cause shown . . .' This is the equity rule (5 Collier on Bankruptcy (1944) p. 537) which permits the filing of claims out of time provided the claim is equitable, the claimant is not chargeable with laches, and the assets have not been distributed (see *Conklin* v. *United States Shipbuilding Co.*, 136 F. 1006, 1009–1010; *Pennsylvania Steel Co.* v. *New York City R. Co.*, 198 F. 721, 740–742); and provided further that the late filing does not unduly delay the proceedings. *Guaranty Trust Co.* v. *Henwood*, 86 F. 2d 347, 353."

A plan of reorganization may provide for "the sale of all or any part of the property of the debtor either subject to or free from *any lien* at not less than a fair upset price". § 77 (b) (5). (Italics added.) It may order "the distribution of all or any assets, or the proceeds derived from the sale thereof, among those having an interest therein". *Id.* Or it may provide for "the satisfaction or modification of *any liens*" or "the curing or waiver of defaults". *Id.* (Italics added.) This is comprehensive language suggesting that all liens are included, not that some are beyond the reach of the court. While valid liens existing at the commencement of bankruptcy proceedings have always been preserved, it has long been a function of the bankruptcy court to ascertain their validity and extent and to determine the method of their liquidation. *Whitney* v. *Wenman*, 198 U. S. 539, 552; *Isaacs* v. *Hobbs Tie & Timber Co.*, 282 U. S. 734, 737–738; *Straton* v. *New*, 283 U. S. 318, 321. Moreover, both in receivership cases, *New York* v. *Maclay*, 288 U. S. 290; *United States* v. *Texas*, 314 U. S. 480, and in bankruptcy cases, *Van Huffel* v. *Harkelrode*, 284 U. S. 225; *New York* v. *Irving Trust Co.*, *supra*, the authority of the court to deal with the lien of a State has long been recognized. In reorganization cases the task of resolving disputes as to liens is a common one for the court. See *Institutional Investors* v. *Chicago, St. P. & P. R. Co.*, 318 U. S. 523, 569. Indeed, before a plan of reorganization can be designed in accord with fair and equitable requirements, liens must be disentangled and their relative priorities ascertained. This problem, present in most reorganizations, is acute in the railroad field.

If the reorganization court lacked the power to deal with tax liens of a State, the assertion by a State of a lien would pull out chunks of an estate from the reorganization court and transfer a part of the struggle over the corpus into tax bureaus and other state tribunals. That would not only seriously impair the power of the court to administer

the estate and adversely affect the power of the Interstate Commerce Commission and the court to promulgate a reorganization plan. See *Ecker* v. *Western Pacific R. Corp.*, 318 U. S. 448, 466–475; *Smith* v. *Hoboken Railroad, W. & S. C. Co.*, 328 U. S. 123. It would fly in the teeth of § 77 (a) which grants the reorganization court "exclusive jurisdiction of the debtor and its property wherever located". That jurisdiction is not limited to the prevention of interference with the use of the property by the trustee; it "extends also to the adjudication of questions respecting the title." *Ex parte Baldwin*, 291 U. S. 610, 616; *Thompson* v. *Texas Mexican Ry. Co.*, 328 U. S. 134, 140. It is the exclusive jurisdiction of the reorganization court which gives it power to preserve the railway as a unit and as a going concern and to prevent it from being divided up and dismembered piece-meal. Only in that way can continuous operation of the road be assured and a plan of reorganization be effected which not only safeguards the interests of the various claimants but is also compatible with the public interest. *Continental Bank* v. *Rock Island Ry. Co.*, 294 U. S. 648; *Smith* v. *Hoboken Railroad, W. & S. C. Co.*, *supra*.

When § 77 is read against this historical background and in light of practical requirements, we cannot conceive that Congress gave the reorganization court power less replete than the sweeping language of § 77 suggests.

The constitutional authority of Congress to grant the bankruptcy court power to deal with the lien of a State has been settled. In *Van Huffel* v. *Harkelrode*, *supra*, the Court held that the bankruptcy court was constitutionally empowered to order a sale of property of a bankrupt free and clear of a lien of a State for taxes.

We hold that the reorganization court has jurisdiction over all of the property of the debtor including that on which New Jersey asserts a lien and that the power of the

court to deal with liens extends to the lien which New Jersey claims.[7]

*Third.* We held in *Arkansas Corporation Commission* v. *Thompson, supra,* that the reorganization court lacked the power under § 77 to redetermine for state tax purposes the property value of a railroad where that value had already been determined in state proceedings which afforded ample protection to the railroad's rights. We adhere to that decision. Its ruling precludes redetermination by the reorganization court in this case of the valuations underlying the assessments made by the state authorities and the validity of those assessments used as the basis for the computation of the taxes. It may not therefore entertain the objections to New Jersey's claim which tender those issues. The proper tribunals where those issues may be litigated, if they are still open for any year, are the state agencies and courts and, under special circumstances, the federal courts. *Hillsborough* v. *Cromwell,* 326 U. S. 620. The Circuit Court of Appeals has reviewed at length the New Jersey procedure available for challenging the valuations which underly assessments. 152 F. 2d pp. 411–414. By the standards of *Arkansas Corporation Commission* v. *Thompson, supra,* that procedure is adequate, so that relitigation of the question in the reorganization proceedings would not be appropriate.

*Fourth.* The rule of *Arkansas Corporation Commission* v. *Thompson, supra,* does not, however, preclude the reorganization court from adjudicating the other issues raised

[7] Section 64a of the Bankruptcy Act determines the priority to which taxes owing a State are entitled and grants the bankruptcy court power to determine questions concerning "the amount or legality of any taxes". In *Arkansas Corporation Commission* v. *Thompson, supra,* we reserved decision on whether § 64a was applicable in reorganizations under § 77. We do not reach that question here. For § 77 alone is adequate to sustain the asserted jurisdiction of the reorganization court over all the property of the debtor. See *Lyford* v. *City of New York,* 137 F. 2d 782, 785–786.

by the objections to New Jersey's claim. The contrary view, which the Circuit Court of Appeals apparently took, fails to recognize historic bankruptcy powers which, as we have already pointed out,[8] are part of the arsenal of authority granted the reorganization court by § 77.

(1) The validity and priority of one lien, whether or not claimed by a State, as against other liens, are questions for the reorganization court. Illustrating but not limiting the range of that inquiry are questions whether local law creates the lien asserted; whether it was sufficiently perfected prior to the petition for reorganization as to be good against other liens, *cf. New York* v. *Maclay, supra; United States* v. *Texas, supra;* whether, if it were inchoate at that time, it could be perfected subsequent to the petition, *Lyford* v. *State of New York*, 140 F. 2d 840; and whether the lien, though paramount, is subordinate to administration expenses or other claims under either the general bankruptcy rule, *City of New York* v. *Hall*, 139 F. 2d 935, or the equity rule,[9] 5 Collier on Bankruptcy (14th ed.) ¶ 77.21. See *Warren* v. *Palmer*, 310 U. S. 132.

(2) The extent of the lien—to what property it applies, and whether it is restricted to realty or covers personal property or revenues as well—are also questions for the reorganization court. See *Ecker* v. *Western Pacific R. Corp., supra*, pp. 489, 503.

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[8] As stated in *Isaacs* v. *Hobbs Tie & Timber Co., supra*, p. 738, "while valid liens existing at the time of the commencement of a bankruptcy proceeding are preserved, it is solely within the power of a court of bankruptcy to ascertain their validity and amount and to decree the method of their liquidation."

[9] Section 77 (a) provides that if the petition is approved the reorganization court "during the pendency of the proceedings under this section and for the purposes thereof, . . . shall have and may exercise in addition to the powers conferred by this section all the powers, not inconsistent with this section, which a Federal court would have had if it had appoin[illegible] a receiver in equity of the property of the debtor for any purpose."

(3) The reorganization court may also adjudicate questions pertaining to the amount of a tax claim secured by a lien without crossing the forbidden line marked by *Arkansas Corporation Commission* v. *Thompson, supra.* There is, for example, the question whether the amount of the claim has been swollen by the inclusion of a forbidden penalty and thus to that extent does not meet the bankruptcy requirements for proof and allowance of claims. Section 57j of the Bankruptcy Act provides that debts owing a State as a "penalty or forfeiture" [10] shall not be allowed. What claims accruing before bankruptcy and sought to be proved by a State are "penalties", *New York* v. *Jersawit*, 263 U. S. 493, and what are not, *Meilink* v. *Unemployment Reserves Commission*, 314 U. S. 564; the applicability of § 57j to reorganizations under § 77; [11] the liability of the estate for penalties incurred by the trustee in the operation of the business *Boteler* v. *Ingels*, 308 U. S. 57; what interest, if any, accrues after the petition for reorganization has been filed, *Vanston* v. *Green*, 329 U. S. —, are all questions for the reorganization court.

(4) We noted in *Case* v. *Los Angeles Lumber Products Co.*, 308 U. S. 106, 130, that one useful and fitting function of a reorganization court was the compromise or settlement of claims, so that interminable litigation might be

[10] Section 57j reads in full:

"Debts owing to the United States or any State or subdivision thereof as a penalty or forfeiture shall not be allowed, except for the amount of the pecuniary loss sustained by the act, transaction, or proceeding out of which the penalty or forfeiture arose, with reasonable and actual costs occasioned thereby and such interest as may have accrued thereon according to law."

[11] Section 77 (l) provides:

"In proceedings under this section and consistent with the provisions thereof, the jurisdiction and powers of the court, the duties of the debtor and the rights and liabilities of creditors, and of all persons with respect to the debtor and its property, shall be the same as if a voluntary petition for adjudication had been filed and a decree of adjudication had been entered on the day when the debtor's petition was filed."

ended and the interests of expedition in promulgating a plan of reorganization served. That power, expressly included in the Bankruptcy Act [12] and governed by our General Order No. 33 [13] is part of the broad authority granted the reorganization court by § 77.[14] Through the appropriate exercise of that power, the court may authorize the trustee to compromise claims, secured or unsecured, and may approve equitable adjustments of them, and so reduce or otherwise affect the participation that the claimant, whether a State or another, may have in the *res* which is *in custodia legis.*

It is urged in this case that the settlement and compromise of New Jersey's tax claim which the reorganization court authorized the trustee to make under the so-called settlement acts of the New Jersey legislature of 1941 and 1942 was an appropriate exercise of that power; that the compromise was valid and binding under New Jersey law; and that even if the compromise was not valid, payments made by the trustee and the conduct of the parties have altered the claim as respects the lien, the principal amount of the claim, and the interest or penalty portion of it. New Jersey vigorously contests all and each of these contentions.

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[12] Section 27 provides:

"The receiver or trustee may, with the approval of the court, compromise any controversy arising in the administration of the estate upon such terms as he may deem for the best interest of the estate."

[13] General Order No. 33 provides:

"Whenever a receiver, trustee or debtor in possession shall make application to the court for authority to submit to arbitration any controversy arising in the settlement of an estate, or for authority to compromise any such controversy, the application shall clearly and distinctly set forth the subject matter of the controversy, and the reasons why it is proper and for the best interest of the estate that the controversy should be settled by arbitration or compromise." 305 U. S. App. 16.

[14] See § 77 (l), note 11, *supra*, and § 77 (a), note 9, *supra*.

A phase of this controversy was before the Circuit Court of Appeals in *In re Central R. Co. of New Jersey, supra.* That court had before it on appeal the order of the reorganization court (entered prior to the decision in *Wilentz* v. *Hendrickson, supra,* holding the acts of 1941 and 1942 unconstitutional) which, on the basis of the compromise, allowed New Jersey's claim only in a reduced amount. The Circuit Court of Appeals held (1) that it would have been more appropriate for the reorganization court to have stayed its hand pending determination of the state litigation and (2) that in any event, it should not have passed on the constitutionality of the 1941 and 1942 acts without giving New Jersey an opportunity for a hearing and argument on the issue. This controversy is now in a different posture. New questions of local law emerge—whether *Wilentz* v. *Hendrickson, supra,* controls this case; whether a valid settlement can be made under an unconstitutional act and, if so, whether this alleged compromise was valid and effective; whether, if the settlement was not binding, the amount of the claim or the extent of the lien has been altered by the payments made during reorganization or by the conduct of the parties.

These points have been briefed and argued here. The difficulty is that neither the reorganization court nor the Circuit Court of Appeals passed on them. The reorganization court passed solely on a question of jurisdiction—whether it had the power to make adjudications concerning the amount of New Jersey's claim which should be allowed and the validity and extent of her lien, or whether New Jersey's sovereign immunity stood in the way of such determinations. And the Circuit Court of Appeals did not pass on these questions because it, too, was concerned solely with the question of jurisdiction.

These issues bristle with questions of New Jersey law on which we should not pass, even if we were to assume they are properly here, without the benefit of the views of

judges who sit there and have a greater familiarity with local law and local practices than we. See *Huddleston* v. *Dwyer*, 322 U. S. 232, 237; *Brillhart* v. *Excess Insurance Co.*, 316 U. S. 491, 497; *Hammond* v. *Schappi Bus Line*, 275 U. S. 164, 169; *Wilson Cypress Co.* v. *Del Pozo*, 236 U. S. 635, 656–657. And for a review of the earlier cases, see dissenting opinion of Mr. Justice Brandeis in *Railroad Commission* v. *Los Angeles R. Co.*, 280 U. S. 145, 164–165. Moreover, we are now advised that there is presently pending before the Circuit Court of Appeals an appeal by the Attorney General of New Jersey from an order of the reorganization court denying leave to join the trustee as party defendant in a suit in the New Jersey courts to determine whether there was a valid settlement of the tax claims and to stay further determination of that controversy in the federal court until the state courts have passed on the question.[15] If the Circuit Court of Appeals orders the application granted, cf. *Thompson* v. *Magnolia Petroleum Co.*, 309 U. S. 478, 483; *Ex parte Baldwin*, *supra*, p. 619, the state law phases of the controversy will be authoritatively settled. If the other course is followed, the issues can be resolved by the reorganization court on a record more adequate than the present one for purposes of review. Whatever procedure is followed it is more fitting that those more versed than we in the intricacies and niceties of New Jersey law first pass on these questions.

We intimate no opinion on the merits of the settlement controversy. Nor do we intimate any view on the amount of the tax claim which should be allowed or on the validity, character, priority, or extent of the lien asserted by New Jersey, or on the manner in which it should be satisfied in a plan for reorganization. We only hold that the reor-

[15] *New Jersey et al.* v. *Central Railroad Co. of New Jersey*, No. 8808. We are advised that by stipulation of the parties the case is being held in the Circuit Court of Appeals until the jurisdictional question involved in the instant case has been decided.

ganization court could properly entertain all objections to the claim except those involving the valuations underlying the assessments and the validity of those assessments.

On the present record we do not know all the issues that were involved in the prolonged litigation concerning the taxes for the years in question. Hence, what we have said is subject to the limitation that *res judicata* may have made binding on the reorganization court various questions of local law, including the amount and validity of the taxes under New Jersey law and the character and extent of the lien which that law affords them.

We affirm in part and reverse in part the judgment of the Circuit Court of Appeals and remand the cause to the District Court for further proceedings in conformity with this opinion.

*So ordered.*